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UNITED STATES DISTRICT COURT  
 NORTHERN DISTRICT OF CALIFORNIA  
 SAN FRANCISCO DIVISION

RICHARD GULBRANDSEN, Derivatively  
 on Behalf of WELLS FARGO &  
 COMPANY,

Plaintiff,

v.

JOHN G. STUMPF, CYNTHIA H.  
 MILLIGAN, PHILIP J. QUIGLEY, SUSAN  
 G. SWENSON, JUDITH M. RUNSTAD,  
 ENRIQUE HERNANDEZ, JR., LLOYD H.  
 DEAN, NICHOLAS G. MOORE, JOHN D.  
 BAKER II, SUSAN E. ENGEL, STEPHEN  
 W. SANGER, JOHN S. CHEN, DONALD  
 M. JAMES, RICHARD M. KOVACEVICH,  
 HOWARD I. ATKINS, J.A. BLANCHARD,  
 III, REATHA CLARK KING, ROBERT L.  
 JOSS, RICHARD D. MCCORMICK,  
 MICHAEL W. WRIGHT, DONALD B.  
 RICE, BENJAMIN F. MONTOYA,  
 ROBERT K. STEEL, and MACKEY J.  
 MCDONALD,

Defendants,

-and-

WELLS FARGO & COMPANY, a  
 Delaware corporation,

Nominal Defendant.

Case No.

12 5968

VERIFIED SHAREHOLDER DERIVATIVE  
 COMPLAINT FOR BREACH OF  
 FIDUCIARY DUTY, WASTE OF  
 CORPORATE ASSETS, AND UNJUST  
 ENRICHMENT

DEMAND FOR JURY TRIAL

1. This is a verified shareholder derivative action brought by plaintiff, a shareholder of Wells Fargo & Company ("Wells Fargo" or the "Company"), on behalf of the Company against certain of its current and former officers and directors. This action seeks to remedy the defendants' violations of law addressed herein, including breach of fiduciary duty, waste of corporate assets, and unjust enrichment that have caused substantial damage to Wells Fargo.

1. This is a verified shareholder derivative action brought by plaintiff, a shareholder of Wells Fargo & Company ("Wells Fargo" or the "Company"), on behalf of the Company against certain of its current and former officers and directors. This action seeks to remedy the defendants' violations of law addressed herein, including breach of fiduciary duty, waste of corporate assets, and unjust enrichment that have caused substantial damage to Wells Fargo.

2. This action arises out of the Individual Defendants' (as defined herein) illicit business practices concerning the Company's involvement in the origination, underwriting, and reporting of materially deficient residential mortgage loans. As set forth more fully below, Wells Fargo, the nation's largest residential mortgage lender, engaged in these improper business practices over the course of almost a decade, from May 2001 through December 2010. During this extensive period, Wells Fargo improperly certified to the United States Department of Housing and Urban Development ("HUD") that over 100,000 of its high-risk residential mortgage loans met HUD's requirements for proper origination and underwriting, and therefore were eligible for the Federal Housing Administration's ("FHA") insurance. In so doing, the Individual Defendants shifted responsibility for these materially deficient loans to the United States Government. Under the FHA Direct Endorsement program, HUD insured the loans that Wells Fargo was originating. Thus, when the loans defaulted, it was the United States Government on the hook, not the Company. The Individual Defendants knew or recklessly disregarded that a very substantial percentage of the Company's loans — nearly half of the loans in certain months — had not been properly underwritten, contained unacceptable risk, and were ineligible for FHA insurance.

3. The extremely poor quality of Wells Fargo's loans was a function of the Individual Defendants' singular focus on increasing the volume of FHA residential mortgage loans, rather than on the quality of the loans being originated. The Company's actions in implementing this plan included: (i) hiring temporary staff to churn out and approve an ever-increasing quantity of FHA loans; (ii) failing to provide its inexperienced staff with proper training; (iii) paying improper bonuses to its underwriters to incentivize them to approve as many

1 FHA loans as possible; and (iv) applying pressure on loan officers and underwriters to originate  
2 and approve more and more FHA loans as quickly as possible. As a consequence of Wells  
3 Fargo's misconduct, the FHA was required to pay hundreds of millions of dollars in insurance  
4 claims on defaulted loans that the Company had falsely certified met HUD's requirements.

5 4. The Individual Defendants caused Wells Fargo to purposely violate HUD  
6 reporting requirements by keeping its materially deficient loans a secret. The Individual  
7 Defendants were well aware that HUD regulations required the Company to perform monthly  
8 reviews of its FHA loan portfolio and to self-report to HUD any loan that was affected by fraud  
9 or other serious violations. This requirement permitted HUD to investigate the bad loans and  
10 request reimbursement or indemnification from the Company, as appropriate. But, although the  
11 Company generally performed the monthly loan reviews and internally identified over 6,000  
12 materially deficient loans during this period, including over 3,000 loans that had gone into  
13 default within the first six months after origination (known as "Early Payment Defaults" or  
14 "EPDs"), the Individual Defendants chose to ignore these blatant red flags and not comply with  
15 the Company's self-reporting obligation to HUD.

16 5. When the U.S. Government learned about the Company's actions, it acted to  
17 recoup its losses. The Company now faces hundreds of millions of dollars in civil liability  
18 arising from a lawsuit filed by the United States Attorney's Office for the Southern District of  
19 New York. In particular, the United States seeks to recover treble damages and civil penalties  
20 under the False Claims Act, civil penalties under the Financial Institutions Reform, Recovery,  
21 and Enforcement Act of 1989, and common-law damages arising from the fraud on HUD in  
22 connection with Wells Fargo's residential mortgage lending business.

23 6. Plaintiff brings this action against the Individual Defendants to repair the harm  
24 that they caused with their faithless actions.

#### 25 JURISDICTION AND VENUE

26 7. Jurisdiction is conferred by 28 U.S.C. §1332. Complete diversity among the  
27 parties exists and the amount in controversy exceeds \$75,000, exclusive of interests and costs.



1           8.     This Court has jurisdiction over each defendant named herein because each  
2 defendant is either a corporation that conducts business in and maintains operations in this  
3 District, or is an individual who has sufficient minimum contacts with this District to render the  
4 exercise of jurisdiction by the District courts permissible under traditional notions of fair play  
5 and substantial justice.

6           9.     Venue is proper in this Court in accordance with 28 U.S.C. §1391(a) because: (i)  
7 Wells Fargo maintains its principal place of business in this District; (ii) one or more of the  
8 defendants either resides in or maintains executive offices in this District; (iii) a substantial  
9 portion of the transactions and wrongs complained of herein, including the defendants' primary  
10 participation in the wrongful acts detailed herein, and aiding and abetting and conspiracy in  
11 violation of fiduciary duties owed to Wells Fargo, occurred in this District; and (iv) defendants  
12 have received substantial compensation in this District by doing business here and engaging in  
13 numerous activities that had an effect in this District.

#### 14                                   **INTRADISTRICT ASSIGNMENT**

15           10.    A substantial portion of the transactions and wrongdoings which give rise to the  
16 claims in this action occurred in the County of San Francisco, and as such, this action is properly  
17 assigned to the San Francisco division of this Court.

#### 18                                   **THE PARTIES**

##### 19           **Plaintiff**

20           11.    Plaintiff Richard Gulbrandsen is a shareholder of Wells Fargo and has  
21 continuously held stock since October 2002. Plaintiff is a citizen of Illinois.

##### 22           **Nominal Defendant**

23           12.    Nominal Defendant Wells Fargo is a Delaware corporation and a financial  
24 services company that provides banking, insurance, investments, mortgage, and consumer and  
25 commercial finance internationally and throughout North America. Wells Fargo is designated as  
26  
27  
28

a Direct Endorsement Lender by HUD.<sup>1</sup> Wells Fargo is the parent company of Wells Fargo Home Mortgage. Wells Fargo's principal executive offices are located at 420 Montgomery Street, San Francisco, California. Thus, Wells Fargo is a citizen of both Delaware and California.

## Defendants

13. Defendant John G. Stumpf ("Stumpf") is Wells Fargo's Chief Executive Officer ("CEO") and has been since June 2007; President and has been since August 2005; Chairman of the Board of Directors ("Board") and has been since January 2010; and a director and has been since June 2006. Defendant Stumpf was also Wells Fargo's Chief Operating Officer from August 2005 to June 2007 and Group Executive Vice President, Community Banking from July 2002 to August 2005. Defendant Stumpf has served in various other positions at Wells Fargo and its predecessor since joining the Company in 1982. Defendant Stumpf knowingly, recklessly, or with gross negligence: (i) caused the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Stumpf the following compensation as an executive:

Year	Salary	Bonus	Other Annual Compensation	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change In Pension Value	Securities Underlying Options	All Other Compensation	Total
2011	\$2,800,000	-	-	\$12,000,026	-	\$3,100,000	\$1,928,295	-	\$14,700	\$19,843,021
2010	\$3,238,847	-	-	\$11,000,009	-	\$3,300,000	\$1,405,335	-	\$28,531	\$18,973,722
2009	\$5,600,000	-	-	\$13,083,386	-	-	\$2,584,375	-	\$72,786	\$21,340,547
2008	\$878,920	-	-	-	\$7,920,000	-	-	-	\$242,167	\$9,041,087
2007	\$749,615	-	-	-	\$6,061,488	\$4,200,000	\$3,349,498	-	\$436,857	\$14,797,458
2006	\$700,000	-	-	\$56,736	\$3,057,718	\$5,500,000	\$2,055,327	-	\$385,691	\$11,755,472
2005	\$600,000	\$4,000,000	\$68,422	-	-	-	-	539,378	\$178,500	\$4,846,922
2004	\$470,833	\$2,375,000	\$100,538	-	-	-	-	313,254	\$142,152	\$3,088,523
2003	\$450,000	\$1,900,000	\$184,284	-	-	-	-	275,470	\$148,500	\$2,682,784
2002	\$420,833	\$2,025,000	\$460,290	\$500,018	-	-	-	196,670	\$58,850	\$3,464,991
2001	\$400,000	\$580,000	\$205,180	-	-	-	-	134,340	\$88,800	\$1,253,980

Defendant Stumpf is a citizen of California.

<sup>1</sup> Direct Endorsement Lender designation is given by HUD to mortgage lenders who are required to abide by strict guidelines and quality control standards put in place by HUD. In addition to having the Direct Endorsement Lender status, the mortgage company will also have the ability to not only approve or deny mortgage applications in its sole discretion, but also be able to fund the mortgage loans it has approved.

14. Defendant Cynthia H. Milligan ("Milligan") is a Wells Fargo director and has been since 1992. Defendant Milligan was also a member of Wells Fargo's Audit and Examination Committee from at least March 2001 to at least July 2011. Defendant Milligan knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Milligan the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$199,000	\$140,025	\$18,303	\$357,328
2010	\$138,000	\$70,006	\$119,095	\$327,101
2009	\$143,455	\$70,011	\$106,778	\$320,244
2008	\$137,000	\$70,009	\$45,422	\$252,431
2007	\$121,000	\$70,021	\$29,946	\$220,967
2006	\$103,400	\$65,035	\$31,060	\$199,495

Defendant Milligan is a citizen of Nebraska.

15. Defendant Philip J. Quigley ("Quigley") is a Wells Fargo director and has been since 1994. Defendant Quigley was also Wells Fargo's Lead Director from January 2009 to December 2011. Defendant Quigley is a member of Wells Fargo's Audit and Examination Committee and has been since at least March 2001 and was Chairman of that committee from at least March 2001 to at least March 2008. Defendant Quigley knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Quigley the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$188,000	\$140,025	\$18,117	\$346,142
2010	\$160,000	\$70,006	\$118,833	\$348,839
2009	\$167,000	\$70,011	\$106,778	\$343,789
2008	\$167,000	\$70,009	\$45,422	\$282,431
2007	\$160,000	\$70,021	\$29,946	\$259,967
2006	\$149,200	\$65,035	\$31,060	\$245,295

Defendant Quigley is a citizen of California.

16. Defendant Susan G. Swenson ("Swenson") is a Wells Fargo director and has been since 1994. Defendant Swenson is also a member of Wells Fargo's Audit and Examination Committee and has been since at least March 2001. Defendant Swenson knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Swenson the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$125,000	\$140,025	-	\$265,025
2010	\$113,000	\$70,006	\$194,211	\$377,217
2009	\$129,000	\$70,011	\$106,778	\$305,789
2008	\$137,000	\$70,009	\$45,422	\$252,431
2007	\$123,000	\$70,021	\$29,946	\$222,967
2006	\$106,600	\$65,035	\$31,060	\$202,695

Defendant Swenson is a citizen of California.

17. Defendant Judith M. Runstad ("Runstad") is a Wells Fargo director and has been since 1998. Defendant Runstad was also a member of Wells Fargo's Audit and Examination Committee from at least March 2001 to at least March 2006. Defendant Runstad knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Runstad the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$143,000	\$140,025	\$18,303	\$301,328
2010	\$105,000	\$70,006	\$118,913	\$293,919
2009	\$117,000	\$70,011	\$106,778	\$293,789
2008	\$123,000	\$70,009	\$45,422	\$238,431
2007	\$101,000	\$70,021	\$29,946	\$200,967
2006	\$92,200	\$65,035	\$31,060	\$188,295

Defendant Runstad is a citizen of Washington.

18. Defendant Enrique Hernandez, Jr. ("Hernandez") is a Wells Fargo director and has been since January 2003. Defendant Hernandez is also a member of Wells Fargo's Audit and Examination Committee and has been since at least March 2003. Defendant Hernandez knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Hernandez the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$166,000	\$140,025	-	\$306,025
2010	\$128,000	\$70,006	\$106,661	\$304,667
2009	\$150,000	\$70,011	\$106,778	\$326,789
2008	\$154,250	\$70,009	\$45,422	\$269,681
2007	\$117,000	\$70,021	\$29,946	\$216,967
2006	\$95,400	\$65,035	\$31,060	\$191,495

Defendant Hernandez is a citizen of California.

19. Defendant Lloyd H. Dean ("Dean") is a Wells Fargo director and has been since June 2005. Defendant Dean was also a member of Wells Fargo's Audit and Examination Committee from at least March 2006 to at least July 2011. Defendant Dean knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Dean the following compensation as a director:



<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$166,000	\$140,025	-	\$306,025
2010	\$121,000	\$70,006	\$106,661	\$297,667
2009	\$157,000	\$70,011	\$106,778	\$333,789
2008	\$135,000	\$70,009	\$45,422	\$250,431
2007	\$129,000	\$70,021	\$29,946	\$228,967
2006	\$109,800	\$65,035	\$31,060	\$205,895

Defendant Dean is a citizen of California.

20. Defendant Nicholas G. Moore ("Moore") is a Wells Fargo director and has been since February 2006. Defendant Moore is also Chairman of Wells Fargo's Audit and Examination Committee and has been since at least March 2009 and a member of that committee and has been since at least March 2007. Defendant Moore knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Moore the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$163,000	\$140,025	-	\$303,025
2010	\$151,000	\$70,006	\$106,661	\$327,667
2009	\$183,000	\$70,011	\$106,778	\$359,789
2008	\$139,000	\$70,009	\$45,422	\$254,431
2007	\$115,000	\$70,021	\$29,946	\$214,967
2006	\$81,983	\$97,520	\$35,850	\$215,353

Defendant Moore is a citizen of California.

21. Defendant John D. Baker II ("Baker") is a Wells Fargo director and has been since January 2009. Defendant Baker is also a member of Wells Fargo's Audit and Examination Committee and has been since January 2009. Defendant Baker knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Baker the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$151,000	\$140,025	-	\$291,025
2010	\$119,000	\$70,006	\$106,661	\$295,667
2009	\$155,000	\$93,351	\$125,388	\$373,739

Defendant Baker is a citizen of Florida.

22. Defendant Susan E. Engel ("Engel") is a Wells Fargo director and has been since 1998. Defendant Engel knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Engel the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$143,000	\$140,025	\$18,117	\$301,142
2010	\$117,000	\$70,006	\$106,661	\$293,667
2009	\$131,000	\$70,011	\$106,778	\$307,789
2008	\$133,000	\$70,009	\$45,422	\$248,431
2007	\$109,000	\$70,021	\$29,946	\$208,967
2006	\$93,800	\$65,035	\$31,060	\$189,895

Defendant Engel is a citizen of New York.

23. Defendant Stephen W. Sanger ("Sanger") is Wells Fargo's Lead Director and has been since January 2012 and a director and has been since July 2003. Defendant Sanger knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Sanger the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$148,000	\$140,025	-	\$288,025
2010	\$129,000	\$70,006	\$106,661	\$305,667
2009	\$141,000	\$70,011	\$106,778	\$317,789
2008	\$149,000	\$70,009	\$45,422	\$264,431
2007	\$123,000	\$70,021	\$29,946	\$222,967
2006	\$100,733	\$65,035	\$31,060	\$196,828

1 Defendant Sanger is a citizen of Minnesota.

2 24. Defendant John S. Chen ("Chen") is a Wells Fargo director and has been since  
3 September 2006. Defendant Chen knowingly or recklessly: (i) allowed the Company to engage  
4 in improper business practices in connection with the origination, underwriting, and reporting of  
5 residential mortgage loans; and (ii) reviewed and approved improper statements regarding the  
6 purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid  
7 defendant Chen the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$111,000	\$140,025	-	\$251,025
2010	\$99,000	\$70,006	\$106,661	\$275,667
2009	\$113,000	\$70,011	\$106,778	\$289,789
2008	\$111,000	\$70,009	\$45,422	\$226,431
2007	\$91,000	\$70,021	\$37,879	\$198,900
2006	\$26,467	\$65,016	\$9,066	\$100,549

13 Defendant Chen is a citizen of California.

14 25. Defendant Donald M. James ("James") is a Wells Fargo director and has been  
15 since January 2009. Defendant James knowingly or recklessly: (i) allowed the Company to  
16 engage in improper business practices in connection with the origination, underwriting, and  
17 reporting of residential mortgage loans; and (ii) reviewed and approved improper statements  
18 regarding the purported quality of the Company's residential mortgage loans to HUD. Wells  
19 Fargo paid defendant James the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$119,000	\$140,025	-	\$259,025
2010	\$109,000	\$70,006	\$106,661	\$285,667
2009	\$123,000	\$93,351	\$125,388	\$341,739

23 Defendant James is a citizen of Alabama.

24 26. Defendant Richard M. Kovacevich ("Kovacevich") was Wells Fargo's CEO from  
25 November 1998 to June 2007; Chairman of the Board from April 2001 to December 2009; a  
26 director from 1986 to December 2009; and President from November 1998 to August 2005.  
27 Defendant Kovacevich knowingly, recklessly, or with gross negligence: (i) caused the Company  
28 to engage in improper business practices in connection with the origination, underwriting, and

reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Kovacevich the following compensation as an executive:

Year	Salary	Bonus	Other Annual Compensation	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value	Securities Underlying Options	All Other Compensation	Total
2008	\$992,955	-	-	\$2,283,333	-	\$223,028	-	\$250,540	\$3,749,856
2007	\$995,000	-	-	\$11,211,155	\$5,700,000	\$4,364,258	-	\$604,539	\$22,874,852
2006	\$995,000	-	-	\$16,826,148	\$8,500,000	\$2,982,214	-	\$543,521	\$29,846,883
2005	\$995,000	\$7,000,000	\$57,809	-	-	-	1,009,596	\$509,700	\$8,562,509
2004	\$995,000	\$7,500,000	\$259,342	-	-	-	1,853,306	\$509,602	\$9,263,944
2003	\$995,000	\$7,500,000	\$102,661	-	-	-	865,740	\$479,700	\$9,077,361
2002	\$995,000	\$7,000,000	\$96,389	-	-	-	865,330	\$203,700	\$8,295,089
2001	\$995,000	\$2,400,000	\$78,579	-	-	-	1,128,012	\$388,200	\$3,861,779

Defendant Kovacevich is a citizen of California.

27. Defendant Howard I. Atkins ("Atkins") was Wells Fargo's Chief Financial Officer from August 2001 to February 2011; a Senior Executive Vice President from August 2005 to February 2011; and an Executive Vice President from August 2001 to August 2005. Defendant Atkins knowingly, recklessly, or with gross negligence: (i) caused the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Atkins the following compensation as an executive:

Year	Salary	Bonus	Other Annual Compensation	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value	Securities Underlying Options	All Other Compensation	Total
2011	\$176,538	-	-	-	\$462,482	-	\$83,133	-	\$14,700	\$736,853
2010	\$1,957,492	-	-	\$5,500,018	\$77,300	\$1,700,000	\$77,138	-	\$14,700	\$9,326,648
2009	\$3,339,156	-	-	\$6,811,260	\$1,297,622	-	\$118,425	-	\$56,848	\$11,623,311
2008	\$598,767	-	-	-	\$4,149,384	-	\$67,057	-	\$130,974	\$4,946,182
2007	\$600,000	-	-	-	\$2,684,073	\$2,000,000	\$138,999	-	\$251,663	\$5,674,735
2006	\$600,000	-	-	\$116,669	\$1,119,091	\$3,000,000	\$202,576	-	\$250,947	\$5,289,283
2005	\$570,833	\$3,000,000	\$8,624	-	-	-	-	304,169	\$166,250	\$3,745,707
2004	\$550,000	\$2,200,000	\$266,247	-	-	-	-	171,960	\$163,086	\$3,179,333
2003	\$550,000	\$2,200,000	\$148,902	-	-	-	-	196,760	\$132,000	\$3,030,902
2002	\$550,000	\$1,650,000	\$255,836	-	-	-	-	-	-	\$2,455,836
2001	\$222,917	\$412,500	\$50,967	\$5,000,110	-	-	-	253,100	-	\$5,686,494

Defendant Atkins is a citizen of California.

28. Defendant J.A. Blanchard, III ("Blanchard") was a Wells Fargo director from 1996 to April 2006. Defendant Blanchard was also a member of Wells Fargo's Audit and Examination Committee from at least March 2001 to April 2006. Defendant Blanchard knowingly or recklessly: (i) allowed the Company to engage in improper business practices in



1 connection with the origination, underwriting, and reporting of residential mortgage loans; and  
 2 (ii) reviewed and approved improper statements regarding the purported quality of the  
 3 Company's residential mortgage loans to HUD. Wells Fargo paid defendant Blanchard the  
 4 following compensation as a director:

<b>Fiscal</b>	<b>Fees Paid in Cash</b>	<b>Total</b>
<b>Year</b>		
2006	\$42,467	\$42,467

7 Defendant Blanchard is a citizen of Minnesota.

8 29. Defendant Reatha Clark King ("King") was a Wells Fargo and director from 1986  
 9 to April 2006. Defendant King was also a member of Wells Fargo's Audit and Examination  
 10 Committee from at least March 2001 to April 2006. Defendant King knowingly or recklessly: (i)  
 11 allowed the Company to engage in improper business practices in connection with the  
 12 origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and  
 13 approved improper statements regarding the purported quality of the Company's residential  
 14 mortgage loans to HUD. Wells Fargo paid defendant King the following compensation as a  
 15 director:

<b>Fiscal</b>	<b>Fees Paid in Cash</b>	<b>Total</b>
<b>Year</b>		
2006	\$37,667	\$37,667

18 Defendant King is a citizen of Minnesota.

19 30. Defendant Robert L. Joss ("Joss") was a Wells Fargo director from 1999 to July  
 20 2009. Defendant Joss was also a member of Wells Fargo's Audit and Examination Committee  
 21 from at least March 2007 to at least March 2009. Defendant Joss knowingly or recklessly: (i)  
 22 allowed the Company to engage in improper business practices in connection with the  
 23 origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and  
 24 approved improper statements regarding the purported quality of the Company's residential  
 25 mortgage loans to HUD. Wells Fargo paid defendant Joss the following compensation as a  
 26 director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2009	\$90,671	\$70,011	\$106,778	\$267,460
2008	\$158,000	\$70,009	\$45,422	\$273,431
2007	\$150,000	\$70,021	\$29,946	\$249,967
2006	\$132,800	\$65,035	\$31,060	\$228,895

Defendant Joss is a citizen of California.

31. Defendant Richard D. McCormick ("McCormick") was a Wells Fargo director from 1983 to May 2011. Defendant McCormick knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant McCormick the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2011	\$55,250	-	-	\$55,250
2010	\$107,000	\$70,006	\$106,661	\$283,667
2009	\$121,000	\$70,011	\$106,778	\$297,789
2008	\$130,750	\$70,009	\$45,422	\$246,181
2007	\$118,000	\$70,021	\$29,946	\$217,967
2006	\$97,600	\$65,035	\$31,060	\$193,695

Defendant McCormick is a citizen of Colorado.

32. Defendant Michael W. Wright ("Wright") was a Wells Fargo director from 1991 to April 2009. Defendant Wright knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Wright the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2009	\$47,000	-	-	\$47,000
2008	\$125,000	\$70,009	\$45,422	\$240,431
2007	\$105,000	\$70,021	\$29,946	\$204,967
2006	\$95,667	\$65,035	\$31,060	\$191,762

Defendant Wright is a citizen of Florida.

33. Defendant Donald B. Rice ("Rice") was a Wells Fargo and director from 1993 to April 2010 and from 1980 to 1989. Defendant Rice knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Rice the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2010	\$41,000	-	-	\$41,000
2009	\$124,000	\$70,011	\$106,778	\$300,789
2008	\$134,000	\$70,009	\$45,422	\$249,431
2007	\$118,000	\$70,021	\$29,946	\$217,967
2006	\$104,000	\$65,035	\$31,060	\$200,095

Defendant Rice is a citizen of California.

34. Defendant Benjamin F. Montoya ("Montoya") was a Wells Fargo director from 1996 to April 2004. Defendant Montoya knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Defendant Montoya is a citizen of California.

35. Defendant Robert K. Steel ("Steel") was a Wells Fargo director from January 2009 to July 2010. Defendant Steel knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant Steel the following compensation as a director:

<b>Fiscal Year</b>	<b>Fees Paid in Cash</b>	<b>Stock Awards</b>	<b>Option Awards</b>	<b>Total</b>
2010	\$63,750	\$70,006	\$106,661	\$240,417
2009	\$117,000	\$93,351	\$125,388	\$335,739

Defendant Steel is a citizen of Connecticut.

36. Defendant Mackey J. McDonald ("McDonald") was a Wells Fargo director from January 2009 to April 2012. Defendant McDonald knowingly or recklessly: (i) allowed the Company to engage in improper business practices in connection with the origination, underwriting, and reporting of residential mortgage loans; and (ii) reviewed and approved improper statements regarding the purported quality of the Company's residential mortgage loans to HUD. Wells Fargo paid defendant McDonald the following compensation as a director:

Fiscal Year	Fees Paid in Cash	Stock Awards	Option Awards	Total
2011	\$115,000	\$140,025	-	\$255,025
2010	\$105,000	\$70,006	\$106,661	\$281,667
2009	\$121,000	\$93,351	\$125,388	\$339,739

Defendant McDonald is a citizen of North Carolina.

37. The defendants identified in ¶¶13, 26-27 are referred to herein as the "Officer Defendants." The defendants identified in ¶¶13-26, 28-36 are referred to herein as the "Director Defendants." The defendants identified in ¶¶14-21, 28-30 are referred to herein as the "Audit and Examination Committee Defendants." Collectively, the defendants identified in ¶¶13-36 are referred to herein as the "Individual Defendants."

#### **DUTIES OF THE INDIVIDUAL DEFENDANTS**

##### **Fiduciary Duties**

38. By reason of their positions as officers, directors, and/or fiduciaries of Wells Fargo and because of their ability to control the business and corporate affairs of Wells Fargo, the Individual Defendants owed and owe Wells Fargo and its shareholders fiduciary obligations of trust, loyalty, good faith, and due care, and were and are required to use their utmost ability to control and manage Wells Fargo; in a fair, just, honest, and equitable manner. Individual Defendants were and are required to act in furtherance of the best interests of Wells Fargo and its shareholders so as to benefit all shareholders equally and not in furtherance of their personal interest or benefit.

39. Each officer and director of the Company owes to Wells Fargo and its shareholders the fiduciary duty to exercise good faith and diligence in the administration of the



1 affairs of the Company and in the use and preservation of its property and assets, and the highest  
2 obligations of fair dealing.

3 **Audit and Examination Committee Duties**

4       40. Under the Wells Fargo Board's Audit and Examination Committee Charter in  
5 effect since at least February 2000, and updated in 2002, 2004, 2006, 2010, and 2011, the Audit  
6 and Examination Committee Defendants, Baker, Blanchard, Dean, Hernandez, Joss, King,  
7 Milligan, Moore, Quigley, Runstad, and Swenson, owe and/or owed specific duties to Wells  
8 Fargo. According to the Audit and Examination Committee Charter, the Audit and Examination  
9 Committee Defendants are responsible for assisting the Board in "oversee[ing] Company policies  
10 and management activities related to accounting and financial reporting, internal controls,  
11 auditing, operational risk and legal and regulatory compliance...." In particular, the Audit and  
12 Examination Committee Defendants are tasked with reviewing "the enterprise-wide compliance  
13 risk management program, the general condition of compliance in the Company, common issues  
14 across business lines, significant violations of statutes and regulations ... with corrective actions  
15 and schedules for resolution, the reputation risks of significant compliance exposures and other  
16 high-risk concerns." The Audit and Examination Committee was active during the wrongdoing  
17 alleged herein, meeting seven times in 2002; eight times in 2003, 2004, and 2005; twelve times  
18 in 2006; eleven times in 2007; ten times in 2008 and 2009; and nine times in 2010 and 2011.  
19 During these years, the Audit and Examination Committee helped shape the path of the  
20 Company by approving certain improper behavior of the management and encouraging short  
21 term goals and objectives in a way that was detrimental to the Company in the long term.  
22 Defendants Baker, Blanchard, Dean, Hernandez, Joss, King, Milligan, Moore, Quigley, Runstad,  
23 and Swenson, knew or consciously disregarded numerous internal reviews reflecting the low  
24 quality of the Company's loans and its deficient underwriting and reporting practices.

25 **Control, Access, and Authority**

26       41. Individual Defendants, because of their positions of control and authority as  
27 officers and/or directors of Wells Fargo, were able to and did, directly and/or indirectly, exercise  
28

1 control over the wrongful acts complained of herein, as well as the contents of the various public  
2 statements issued by the Company.

3 42. Because of their advisory, executive, managerial, and directorial positions with  
4 Wells Fargo, each Individual Defendant had access to adverse, non-public information about the  
5 Company's mortgage loans.

6 43. At all times relevant hereto, each Individual Defendant was the agent of each of  
7 the other Individual Defendants and of Wells Fargo, and was at all times acting within the course  
8 and scope of such agency.

9 **Reasonable and Prudent Supervision**

10 44. To discharge their duties, the officers and directors of Wells Fargo were required  
11 to exercise reasonable and prudent supervision over the management, policies, practices, and  
12 controls of the financial affairs of the Company. By virtue of such duties, the officers and  
13 directors of Wells Fargo were required to, among other things:

14 (a) ensure that the Company was operated in a diligent, honest, and prudent  
15 manner in compliance with all applicable laws, rules, and regulations;

16 (b) ensure that the Company complied with its legal obligations and  
17 requirements, including acting only within the scope of its legal authority and refrain from  
18 engaging in deceptive or fraudulent conduct;

19 (c) conduct the affairs of the Company in an efficient, business-like manner  
20 so as to make it possible to provide the highest quality performance of its business, to avoid  
21 wasting the Company's assets, and to maximize the value of the Company's stock; and

22 (d) remain informed as to how Wells Fargo conducted its operations, and,  
23 upon receipt of notice or information of imprudent or unsound conditions or practices, make  
24 reasonable inquiry in connection therewith, and take steps to correct such conditions or practices  
25 and make such disclosures as necessary to comply with applicable laws.

26 **Breach of Duties**

27 45. Each Individual Defendant, by virtue of his or her position as an officer and/or  
28 director, owed to the Company the fiduciary duty of loyalty and good faith and the exercise of

1 due care and diligence in the management and administration of the affairs of the Company, as  
2 well as in the use and preservation of its property and assets. The conduct of the Individual  
3 Defendants complained of herein involves a knowing and culpable violation of their obligations  
4 as officers and directors of Wells Fargo, the absence of good faith on their part, and a reckless  
5 disregard for their duties to the Company that the Individual Defendants were aware or reckless  
6 in not being aware posed a risk of serious injury to the Company. The conduct of the Individual  
7 Defendants who were also officers and/or directors of the Company has been ratified by the  
8 remaining Individual Defendants who collectively comprised all of Wells Fargo's Board during  
9 the time of the misconduct.

10 46. The Individual Defendants breached their duty of loyalty and good faith by  
11 allowing defendants to cause, or by themselves causing, the Company to engage in improper  
12 practices that perpetrated a fraud on the Government, and caused Wells Fargo to incur  
13 substantial damage. The Individual Defendants also failed to prevent the other Individual  
14 Defendants from taking such illegal actions. As a result, Wells Fargo has expended, and will  
15 continue to expend, significant sums of money.

16 **CONSPIRACY, AIDING AND ABETTING, AND CONCERTED ACTION**

17 47. In committing the wrongful acts alleged herein, the Individual Defendants have  
18 pursued, or joined in the pursuit of, a common course of conduct, and have acted in concert with  
19 and conspired with one another in furtherance of their common plan or design. In addition to the  
20 wrongful conduct herein alleged as giving rise to primary liability, the Individual Defendants  
21 further aided and abetted and/or assisted each other in breaching their respective duties.

22 48. During all times relevant hereto, the Individual Defendants, collectively and  
23 individually, initiated a course of conduct that: (i) deceived and exploited the Government into  
24 paying for defaults on loans that the Company knew were deficient; and (ii) enhanced their  
25 executive and directorial positions at Wells Fargo and the profits, power, and prestige that they  
26 enjoyed as a result of holding these positions. The Individual Defendants, collectively and  
27 individually, took the actions set forth herein.

28

49. The purpose and effect of the Individual Defendants' conspiracy, common enterprise, and/or common course of conduct was, among other things, to disguise the Individual Defendants' violations of law, breaches of fiduciary duty, waste of corporate assets, and unjust enrichment; and to conceal adverse information concerning the Company's operations.

50. The Individual Defendants accomplished their conspiracy, common enterprise, and/or common course of conduct by causing the Company to purposefully or recklessly mislead the Government regarding the quality of its residential mortgage loans. Because the actions described herein occurred under the authority of the Board, each of the Individual Defendants was a direct, necessary, and substantial participant in the conspiracy, common enterprise, and/or common course of conduct complained of herein.

51. Each of the Individual Defendants aided and abetted and rendered substantial assistance in the wrongs complained of herein. In taking such actions to substantially assist the commission of the wrongdoing complained of herein, each Individual Defendant acted with knowledge of the primary wrongdoing, substantially assisted in the accomplishment of that wrongdoing, and was aware of his or her overall contribution to and furtherance of the wrongdoing.

## SUBSTANTIVE ALLEGATIONS

## The FHA Mortgage Insurance Program

52. FHA, a part of HUD, is the largest mortgage insurer in the world, insuring approximately one-third of all new residential mortgages in the United States. Pursuant to the National Housing Act of 1934, FHA offers various mortgage insurance programs. Through these programs, FHA insures approved lenders ("mortgagees") against losses on mortgage loans made to buyers of single-family housing. The programs help low-income and moderate-income families become homeowners by encouraging mortgage lenders to make loans to creditworthy borrowers who nevertheless might not meet conventional underwriting requirements. In the event that a borrower defaults on an FHA-insured mortgage, the lender or other party holding the mortgage submits a claim to HUD for the costs associated with the defaulted mortgage and the



1 sale of the property. HUD then pays off the balance of the mortgage and other related costs and  
2 may assume ownership of the property.

3 53. HUD's Direct Endorsement Lending program is one of the FHA-insured mortgage  
4 programs. A Direct Endorsement Lender is authorized to underwrite mortgage loans, decide  
5 whether the borrower represents an acceptable credit risk for HUD, and certify loans for FHA  
6 mortgage insurance without prior HUD review or approval. To qualify for FHA mortgage  
7 insurance, a mortgage must meet all of the applicable HUD requirements (e.g., income, credit  
8 history, valuation of property, etc.).

9 54. HUD relies on the expertise and knowledge of Direct Endorsement Lenders in  
10 providing FHA insurance. A Direct Endorsement Lender is, therefore, obligated to act with the  
11 utmost good faith, honesty, fairness, undivided loyalty, and fidelity in dealings with HUD. The  
12 duty of good faith also requires a Direct Endorsement Lender to make full and fair disclosures to  
13 HUD of all material facts and to take on the affirmative duty of employing reasonable care to  
14 avoid misleading HUD in all circumstances.

#### 15 **Underwriting and Due Diligence Requirements**

16 55. A Direct Endorsement Lender is responsible for all aspects of the mortgage  
17 application, the property analysis, and the underwriting of the mortgage. The underwriter must  
18 "evaluate [each] mortgagor's credit characteristics, adequacy and stability of income to meet the  
19 periodic payments under the mortgage and all other obligations, and the adequacy of the  
20 mortgagor's available assets to close the transaction, and render an underwriting decision in  
21 accordance with applicable regulations, policies and procedures." 24 C.F.R. §203.5(d).  
22 Mortgagees must employ underwriters who can detect warning signs that may indicate  
23 irregularities, as well as detect fraud, in addition to the responsibility that underwriting decisions  
24 are performed with due diligence in a prudent manner. HUD Handbook 4000.4 REV-1, ¶2-  
25 4(C)(5); *see also* HUD Handbook 4155.2 ¶2.A.4.b. The lender must also maintain a compliant  
26 compensation system for its staff, an essential element of which is the prohibition on paying  
27 commissions to underwriters. HUD Handbook 4060.1 REV-2, ¶2-9(A).

1           56. HUD relies on Direct Endorsement Lenders to conduct due diligence on Direct  
2 Endorsement loans. The purposes of due diligence include: (i) determining a borrower's ability  
3 and willingness to repay a mortgage debt, thus limiting the probability of default and collection  
4 difficulties, *see* 24 C.F.R. §203.5(d); and (ii) examining a property offered as security for the  
5 loan to determine if it provides sufficient collateral, *see* 24 C.F.R. §203.5(e)(3). Due diligence  
6 thus requires an evaluation of, among other things, a borrower's credit history, capacity to pay,  
7 cash to close, and collateral. In all cases, a Direct Endorsement Lender owes HUD the duty, as  
8 prescribed by federal regulation, to "exercise the same level of care which it would exercise in  
9 obtaining and verifying information for a loan in which the mortgagee would be entirely  
10 dependent on the property as security to protect its investment." 24 C.F.R. §203.5(c).

11           57. HUD has set specific rules for due diligence predicated on sound underwriting  
12 principles. In particular, HUD requires Direct Endorsement Lenders to be familiar with, and to  
13 comply with, governing HUD Handbooks and Mortgagee Letters, which provide detailed  
14 processing instructions to Direct Endorsement Lenders. These materials specify the minimum  
15 due diligence with which Direct Endorsement Lenders must comply. With respect to ensuring  
16 that borrowers have sufficient credit, a Direct Endorsement Lender must comply with governing  
17 HUD Handbooks, such as HUD Handbook 4155.1 (Mortgage Credit Analysis for Mortgage  
18 Insurance on One- to Four-Unit Mortgage Loans), to evaluate a borrower's credit. The rules set  
19 forth in HUD Handbook 4155.1 exist to ensure that a Direct Endorsement Lender sufficiently  
20 evaluates whether a borrower has the ability and willingness to repay the mortgage debt. HUD  
21 has informed Direct Endorsement Lenders that past credit performance serves as an essential  
22 guide in determining a borrower's attitude toward credit obligations and in predicting a  
23 borrower's future actions.

24           58. To properly evaluate a borrower's credit history, a Direct Endorsement Lender  
25 must, at a minimum, obtain and review credit histories; analyze debt obligations; reject  
26 documentation transmitted by unknown or interested parties; inspect documents for proof of  
27 authenticity; obtain adequate explanations for collections, judgments, recent debts, and recent  
28 credit inquiries; establish income stability and make income projections; obtain explanations for

gaps in employment, when required; document any gift funds; calculate debt and income ratios and compare those ratios to the fixed ratios set by HUD rules; and consider and document any factors permitting deviations from those fixed ratios.

59. With respect to appraising the mortgaged property (i.e., collateral for the loan), a Direct Endorsement Lender must ensure that an appraisal and its related documentation satisfy the requirements in governing HUD Handbooks, such as HUD Handbook 4150.2 (Valuation Analysis for Single Family One- to Four-Unit Dwellings). The rules set forth in HUD Handbook 4150.2 exist to ensure that a Direct Endorsement Lender obtains an accurate appraisal that properly determines the value of the property for HUD's mortgage insurance purposes.

#### **Quality Control Requirements**

60. Furthermore, to maintain HUD and FHA approval, a Direct Endorsement Lender must implement and maintain a quality control program. HUD requires the quality control department to be independent of mortgage origination and servicing functions. *See* HUD Handbook 4060.1 REV-1, ¶6-3(B); HUD Handbook 4060.1 REV-2, ¶7-3(B); HUD Handbook 4700.2 REV-1, ¶6-1(A). To comply with HUD's quality control requirements, a lender's quality control program must (among other things): (i) review a prescribed sample of all closed loan files to ensure they were underwritten in accordance with HUD guidelines; and (ii) conduct a full review of "all loans going into default within the first six payments," which HUD defines as "Early Payment Defaults." HUD Handbook 4060.1 REV-1, ¶¶6-6(C), 6-6(D); HUD Handbook 4060.1 REV-2, ¶¶7-6(C), 7-6(D); HUD Handbook 4700.2 REV-1, ¶¶6-1(B), 6-1(D).

61. In conducting a quality control review of a loan file, the lender must, among other things, review and confirm specific items of information. For instance, "[d]ocuments contained in the loan file should be checked for sufficiency and subjected to written re-verification. Examples of items that must be re-verified include, but are not limited to, the mortgagor's employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds." HUD Handbook 4060.1 REV-2, ¶7-6(E)(2). Further, "[a]ny discrepancies must be explored to ensure that the original documents ... were completed before being signed, were as represented, were not handled by interested third parties and that all corrections were proper and

1 initialed." *Id.*; *see also* HUD Handbook 4060.1 REV-1, ¶6-6(E)(2); HUD Handbook 4700.2  
2 REV-1, ¶6-3(A)(2).

3 62. The HUD Handbook lays out a rating system for the quality control reviews, in  
4 which the lender implements a "system of evaluating each Quality Control sample on the basis of  
5 the severity of the violations found during the review. The system should enable a mortgagee to  
6 compare one month's sample to previous samples so the mortgagee may conduct trend analysis."  
7 HUD Handbook 4060.1 REV-2, ¶7-4; *see also* HUD Handbook 4060.1 REV-1, ¶6-4. The  
8 ratings provided, for this purpose, are "Low", i.e., no or minor violations, "Acceptable," i.e.,  
9 issues identified were not material to insurability of the loan, "Moderate," i.e., significant  
10 unresolved questions or missing documentation created a moderate risk to the mortgagee and  
11 FHA, and "Material," i.e., issues identified were material violations of FHA or mortgagee  
12 requirements and represent an unacceptable level of risk, such that the loans must be reported to  
13 HUD. HUD Handbook 4060.1 REV-1, ¶6-4; HUD Handbook 4060.1 REV-2, ¶7-4.

14 63. Specifically, the HUD Handbook defines "Material Risk" loans as follows:

15 The issues identified during the review were material violations of FHA or  
16 mortgagee requirements and represent an unacceptable level of risk. For example,  
17 a significant miscalculation of the insurable mortgage amount or the applicant[']s  
18 capacity to repay, failure to underwrite an assumption or protect abandoned  
19 property from damage, or fraud. Mortgagees must report these loans, in writing,  
20 to the Quality Assurance Division in the FHA Home Ownership Center having  
21 jurisdiction.

22 HUD Handbook 4060.1 REV-2, ¶7-4(D); *see also* HUD Handbook 4060.1 REV-1, ¶6-4(D).

23 64. Under HUD's rules, a lender must report to HUD (along with the supporting  
24 documentation) "[s]erious deficiencies, patterns of noncompliance, or fraud uncovered by  
25 mortgagees" during the "normal course of business and by quality control staff during  
26 reviews/audits of FHA loans" within sixty days of the initial discovery. HUD Handbook 4060.1  
27 REV-1, CHG-1, ¶¶6-13, 6-3(J); *see also* HUD Handbook 4060.1 REV-2, ¶7-3(J) (requiring  
28 Direct Endorsement Lenders to "immediately" report findings of "fraud or other serious  
violations" affecting an FHA loan); HUD Handbook 4060.1 REV-2, ¶2-23 ("Mortgagees are  
required to report to HUD any fraud, illegal acts, irregularities or unethical practices."). Upon



1 making such findings, the lender must also expand the scope of the quality control review both  
2 by increasing the number of files reviewed and conducting a more in-depth review of the  
3 selected files.

4         65.     Until 2005, HUD's rules instructed Direct Endorsement Lenders to make the  
5 required self-reports of loans with serious deficiencies, patterns of noncompliance, or fraud in  
6 writing to HUD through the Quality Assurance Division of the HUD Homeownership Centers  
7 ("HOCs") having jurisdiction. In May 2005, HUD issued Mortgagee Letter 2005-26, which  
8 notified lenders that going forward they would have to participate in mandatory electronic  
9 reporting through HUD's online Neighborhood Watch system. That new method became  
10 mandatory at the end of November 2005, and required mortgagees "to report serious  
11 deficiencies, patterns of noncompliance, or suspected fraud, to HUD in a uniform, automated  
12 fashion" and in lieu of written reports to the various individual HOCs.

13         66.     In addition to reporting loans affected by fraud or other serious violations to  
14 HUD, the lender is required to take corrective action in response to its findings. In particular,  
15 quality control review findings must *"be reported to the mortgagee's senior management within  
16 one month of completion of the initial report"* and "[m]anagement must take prompt action to  
17 deal appropriately with any material findings. The final report or an addendum must identify the  
18 actions being taken, the timetable for their completion, and any planned follow-up activities."  
19 HUD Handbook 4060.1 REV-2, ¶7-3(1); *see also* HUD Handbook 4060.1 REV-1, ¶6-3(1); HUD  
20 Handbook 4700.2 REV-1, ¶6-1(F). Appropriate action by management includes following up  
21 with underwriters responsible for material findings to ensure that they are properly trained and  
22 diligently reviewing each file before endorsing it for FHA mortgage insurance.

23 **Direct Endorsement Lender Certifications**

24         67.     Every Direct Endorsement Lender must make an annual certification of  
25 compliance with the program's qualification requirements, including due diligence in  
26 underwriting and the implementation of a mandatory quality control plan. The annual  
27 certification states:

1 I know or am in the position to know, whether the operations of the above named  
2 mortgagee conform to HUD-FHA regulations, handbooks, and policies. I certify  
3 that to the best of my knowledge, the above named mortgagee conforms to all  
4 HUD-FHA regulations necessary to maintain its HUD-FHA approval, and that the  
above-named mortgagee is fully responsible for all actions of its employees  
including those of its HUD-FHA approved branch offices.

5 Absent a truthful annual certification, a lender is not entitled to maintain its direct endorsement  
6 lender status and is not entitled to endorse loans for FHA insurance.

7 68. In addition to the annual certification requirement, after each mortgage closing,  
8 the Direct Endorsement Lender must certify that the lender conducted due diligence and/or  
9 ensured data integrity such that the endorsed mortgage complies with HUD rules and is "eligible  
10 for HUD mortgage insurance under the Direct Endorsement program." Form HUD-92900-A.  
11 For each loan that was underwritten with an automated underwriting system approved by the  
12 FHA, the lender must additionally certify to "the integrity of the data supplied by the lender used  
13 to determine the quality of the loan [and] that a Direct Endorsement Underwriter reviewed the  
14 appraisal (if applicable)." *Id.* For each loan that required manual underwriting, the lender must  
15 additionally certify that the underwriter "personally reviewed the appraisal report (if applicable),  
16 credit application, and all associated documents and ha[s] used due diligence in underwriting  
17 th[e] mortgage...." *Id.* HUD relies on each certification to endorse the loan and provide the  
18 lender with a mortgage insurance certificate.

19 **Wells Fargo Submits Thousands of False Individual Loan Certifications to HUD**

20 69. Despite specific guidance within the mortgage lending industry, the Individual  
21 Defendants caused Wells Fargo to engage in a regular practice of reckless origination and  
22 underwriting of its retail FHA loans, and falsely certified to HUD that tens of thousands of those  
23 loans were eligible for FHA insurance. Between May 2001 and October 2005, the quality of  
24 Wells Fargo's retail FHA loans was extremely poor. This was a function of the Individual  
25 Defendants' concerted effort to prioritize volume of loans over quality. The Company was  
26 underwriting so many loans that it had to hire temporary staff that it knew would not be  
27 adequately trained. Moreover, the Individual Defendants were able to vastly increase the  
28 Company's FHA loan volume by paying incentive bonuses to underwriters based on the number

1 of loans that they approved. This led to loan officers and underwriters being pressured to  
2 originate and approve as many FHA loans as possible, as quickly as possible. Not surprisingly,  
3 this increase in loan volume came at the expense of loan quality.

4 70. From May 2001 through October 2005, a substantial percentage of the Company's  
5 retail FHA loan portfolio — nearly 50% in certain months — did not comply with HUD quality  
6 requirements, contained an unacceptable level of risk, and therefore was ineligible for HUD  
7 insurance. The Individual Defendants, however, failed to take effective action to address the  
8 seriously deficient loan originations and underwriting. And to avoid any indemnification claims  
9 from the FHA, the Individual Defendants caused Wells Fargo to conceal the fact that it was  
10 having very serious loan quality problems from HUD and failed to self-report, as required, any  
11 of the bad loans. As a result of Wells Fargo's false loan certifications, FHA paid insurance  
12 claims on thousands of defaulted mortgage loans that the Individual Defendants knew, or  
13 recklessly disregarded, did not meet HUD's requirements and were ineligible for FHA insurance.

14 71. The underlying causes of Wells Fargo's loan quality problems and reckless  
15 underwriting are multifold. In or around the middle of 2000, Wells Fargo significantly increased  
16 its FHA loan originations. From January 1, 2001 through December 31, 2002, Wells Fargo  
17 originated or sponsored approximately 225,000 FHA loans. To facilitate this substantial increase  
18 in FHA originations, Wells Fargo expanded its staff, including hiring temporary underwriters to  
19 review FHA loans. Many of these employees were not adequately trained with respect to the  
20 requirements of the FHA program.

21 72. To compound matters, Wells Fargo paid its underwriters a bonus (in addition to  
22 their salaries) based on the number of loans approved, rather than the number of loans reviewed.  
23 This improper *de facto* commission incentivized the underwriters to approve as many FHA loans  
24 as possible, regardless of the risk of default or the loan's eligibility for FHA insurance. Worse  
25 yet, the incentive was tied to the total number of loans approved at a particular underwriting site,  
26 thereby fostering a group dynamic whereby individual underwriters felt pressure from their peers  
27 at the site to approve loans.

28

1       73. Apart from the incentive system, management applied heavy pressure on loan  
2 officers and underwriters to originate, approve, and close loans. And management required  
3 underwriters to make decisions on loans on extremely short turnaround times and employed lax  
4 and inconsistent underwriting standards and controls.

5       74. The extraordinarily heavy volume of FHA loans also overwhelmed Wells Fargo's  
6 FHA underwriters and further contributed to the extremely poor loan quality. This heavy  
7 volume was particularly problematic given the underwriting staff's general lack of experience.

8 **Wells Fargo's Internal Reviews Alert the Individual Defendants to Multiple Red Flags**

9       75. Wells Fargo's home mortgage division's quality control function included both the  
10 Fraud Risk Management ("FRM") and Quality Assurance ("QA") departments. The QA  
11 department's procedures included the following with respect to FHA-insured loans: monthly  
12 reviews of a random sample of loans originated and sponsored within the prior sixty days,  
13 reviews of at least some portion of its EPDs, and preparation and circulation of internal reports  
14 of the reviews' findings. The FRM department also reviewed loans referred to it as potentially  
15 involving fraud or misrepresentations. The FRM department had several sources for these  
16 referrals, including the QA department, its branches, and the Company's fraud reporting hotline.

17       76. In evaluating the loans it reviewed, Wells Fargo tracked HUD Handbook  
18 terminology, rating its findings regarding the risks of the loans as either "Material," "Moderate,"  
19 or "Acceptable." Wells Fargo's definition for the "Material" rating mirrored HUD's in substance,  
20 and indicated that a loan with that rating contained unacceptable risk and was ineligible for FHA  
21 insurance. Specifically, Wells Fargo's definition of the "Material" rating in October 2002 was as  
22 follows:

23       The loan contains significant deviations from the specific loan program  
24 parameters under which it was originated, making the loan ineligible for sale to  
25 the investor or resulting in potential repurchase or indemnification. [And/or] The  
26 loan contains significant risk factors affecting the underwriting decision and/or  
contains misrepresentation, which may render the loan non-investment quality.

27       77. Wells Fargo's May 2004 Quality Control Plan for FHA loans, which was provided  
28 to HUD, similarly defined "Material risk" rated loans as follows:



1 The loan contains significant deviations from the specific loan program  
2 parameters under which it was originated or significant risk factors affecting the  
3 underwriting decision and/or contains misrepresentation, making the loan  
ineligible for sale to the investor or resulting in potential repurchase or  
indemnification.

4 That Plan also included examples drawn directly from the HUD Handbook's definition of  
5 "Material risk" loans, stating: "Examples of material risks include the applicant's capacity to  
6 repay the mortgage, failure to underwrite an assumption or protect abandoned property from  
7 damage, or fraud."

8 78. Both the QA and FRM departments made monthly reports to senior management.  
9 These reports were then shared with the Board because as explained in Wells Fargo's Corporate  
10 Governance Guidelines, "[t]he business of [Wells Fargo] is managed under the direction of its  
11 Board" and the Board "delegates the conduct of business to the Company's officers, managers  
12 and employees...." In particular, Wells Fargo's QA department provided written reports,  
13 summarizing its findings resulting from QA's reviews of statistically random monthly samples of  
14 loans, as well as loans that were categorized as EPDs. Among other information, those QA  
15 reports summarized the percentage of loans reviewed in various categories and lines of business  
16 that contained "Material" risk ratings.

17 79. Where FRM received a referral and conducted an initial review of a loan, if the  
18 loan file indicated there may have been origination and underwriting violations, FRM performed  
19 a "deep dive" review. In this "deep dive," the FRM reviewers sought to verify the employment  
20 and income, whether "middle men" were being used for purchases, the validity of appraisals, and  
21 other items. On the retail side of home mortgage, according to a former Wells Fargo FRM  
22 manager, these reviews exposed a "dirty underbelly of bad loan officers."

23 80. Through these internal reviews, Wells Fargo's QA division detected the decline in  
24 the Company's loan quality and reported these results to senior management. For example, QA's  
25 report for loans originated in December 2000 advised that 26% of the retail FHA loans that were  
26 randomly sampled contained a material violation of HUD's requirements. In other words, based  
27 on Wells Fargo's sampling, greater than one out of every four retail FHA loans that the Company  
28

1 originated in December 2000 and certified to HUD for FHA insurance bore unacceptable risk  
2 and did not meet HUD's requirements. The report for December 2000 originations was  
3 consistent with prior monthly QA reports from the summer and fall of 2000 showing material  
4 violation rates in randomly sampled retail FHA loans of between about 15% to 20%.

5 81. Despite these troubling findings and blatant red flags, the Individual Defendants  
6 failed to take action to address these issues. No written action plans were prepared for loans with  
7 material violations. Corrective action for such loans was not formally tracked. There was little  
8 to no follow-up on the material violations. And Wells Fargo failed to self-report any of these  
9 loans with serious deficiencies to HUD. Instead, Wells Fargo continued on the same path,  
10 originating tens of thousands of FHA loans with the same reckless underwriting, and certifying  
11 its entire portfolio of FHA loans for insurance.

12 82. As a result, the material violation rate worsened significantly beginning in May  
13 2001, and escalated throughout 2002. Based on Wells Fargo's own QA findings, during the  
14 twenty-one months from May 2001 through January 2003, the material violation rate for  
15 randomly reviewed FHA loans exceeded 25% in eighteen of those months. That means that at  
16 least one out of every four retail FHA loans that Wells Fargo certified to HUD for FHA  
17 insurance during those months did not qualify, and the Individual Defendants knew or recklessly  
18 disregarded this fact.

19 83. Even worse, during a seven-month stretch from April 2002 through October 2002,  
20 the material violation rate never dipped below 42%, and reached as high as 48%. That means  
21 that during those months nearly one out of every two retail FHA loans that Wells Fargo certified  
22 to HUD did not qualify for insurance. This was another red flag that the Individual Defendants  
23 knew or recklessly disregarded. This was an extraordinary departure from Wells Fargo's internal  
24 benchmark for material violations, which was set at 5%. And QA's material violation rate for  
25 FHA loans that went into early payment default was even higher, averaging 66% in 2002, and  
26 hitting an astronomical high of nearly 90% in one of those months.

27 84. As shown by Wells Fargo's internal QA reports from February 2003 through  
28 October 2005, month after month QA reported to management about the significant problems it

1 was finding with respect to the Company's retail FHA loans. Despite these reports, and QA's  
2 increasingly specific direction to management about the very serious underwriting problems, no  
3 effective action was taken. For example, in July 2003, QA candidly advised that one of the  
4 "overall root cause[s]" for the exceedingly high material violation rates in underwriting across all  
5 business lines was "[v]olume, pressure to approve loans, and the experience levels." QA was  
6 even more explicit in its August 2003 report on the same issue: "heavy volume, pressure to  
7 approve loans and meet acceptable turn times along with inexperienced staff are key contributing  
8 factors overall to the issues leading to material findings." Despite these blatant red flags, the  
9 Individual Defendants did not change course.

10 85. Instead of limiting its FHA originations or training an appropriate underwriting  
11 staff to match the volume of loans the bank was originating, Wells Fargo slashed the number of  
12 its FHA underwriters from 919 to 401. This smaller crew of underwriters remained inadequately  
13 trained, and the Company's improper bonus system for underwriters continued throughout this  
14 period.

15 86. Consequently, Wells Fargo's QA reports show that the material violation rate for  
16 randomly sampled retail FHA loans remained very high, over 20% in many months. At the same  
17 time, the moderate violation rate skyrocketed. For a number of months during this period, the  
18 combined material and moderate violation rate exceeded 80% of the randomly sampled retail  
19 FHA loans, hitting a high of 87.2% in July 2003. And for eighteen consecutive months that  
20 combined rate hovered between 70% and 80% and never fell below 63%. This astoundingly  
21 high violation rate - including the moderate violations - was a very serious problem because the  
22 "moderate" risk rating classification encompassed underwriting violations that actually were  
23 material to whether the loans met HUD's requirements and were eligible for FHA insurance.  
24 The "moderate" rated loans in this and prior periods included loan files that lacked support for  
25 critical borrower income and asset information, including missing or incomplete verifications of  
26 employment, missing income, asset, and debt documentation, incorrect calculations of income,  
27 and social security number discrepancies. For example, one QA report in this period identified  
28 "moderate" and "material" violations as follows: "Critical documentation needed for either loan

1 decisioning or program requirements are missing ... Examples noted were employment gaps,  
2 discrepancies on pay-stubs for hours worked, ytd earnings that don't coincide with current  
3 earnings, etc." Indeed, QA noted that "[i]n many instances the only difference between a  
4 moderate or material rating are the loan characteristics. Therefore, attention should be given to  
5 all deficiencies if improved quality is to be achieved and maintained."

6 **Wells Fargo Fails to Report Bad Loans to HUD**

7 114. As discussed above, HUD required Direct Endorsement Lenders to perform post-  
8 closing reviews of the FHA loans they originated and to report to HUD loans that had an  
9 unacceptable risk. This requirement provided HUD with an opportunity to investigate the loans  
10 and request reimbursement or indemnification, as appropriate. The Individual Defendants,  
11 however, decided unilaterally that Well Fargo did not have to comply with this requirement.

12 115. Prior to 2003, the self-reporting regulation required lenders to report loans that  
13 contained "significant discrepancies," such as "any violation of law or regulation, false  
14 statements or program abuses...." HUD Handbook 4060.1 REV-1, ¶6-1(H) (1993). In 2003, the  
15 requirement was amended to require reporting of "serious deficiencies, patterns of  
16 noncompliance or fraud," HUD Handbook 4060.1 REV-1, CHG-1, ¶6-13 (2003), and lenders  
17 were instructed that loans identified as having material violations by the bank's quality control  
18 'had to be reported, *id.* ¶6-3(J). And in 2006, the requirement was restated to require reporting of  
19 "[f]indings of fraud or other serious violations," to include any material violations found by  
20 quality control. HUD Handbook 4060.1 REV-2, ¶7-3(J), 7-4(D) (2006).

21 116. Wells Fargo's internal memoranda demonstrate that the Individual Defendants  
22 were aware of HUD's requirement to report in writing loans affected by fraud and other serious  
23 violations, and that the Company ignored this obligation. Wells Fargo's Quality Control plan,  
24 which was provided to HUD in or about May 2004, declared that the Company would report to  
25 HUD "when fraud or other serious violations of FHA requirements are identified (whether  
26 during the normal course of business or by Quality Control staff during reviews/audits of FHA  
27 loans)." Similarly, a Wells Fargo internal memorandum from August 2005 confirmed that the  
28



1 Company knew that "HUD has always requested significant findings or fraud on FHA loans be  
2 reported to HUD."

3 117. Behind closed doors, however, the Individual Defendants decided to disregard the  
4 self-reporting requirement entirely. They did so by simply ignoring the Company's self-  
5 reporting obligations prior to 2004, and then redefining the reporting requirement so narrowly as  
6 to eliminate it. At or about the time of a HUD-Office of the Inspector General audit in 2004,  
7 Wells Fargo management first began to concern itself with the topic of reporting bad loans to  
8 HUD. According to a memorandum dated April 8, 2004, the Vice President of Division Quality  
9 Management (the "VP of Quality Control") was "organiz[ing] a working group to address  
10 reporting to HUD." This "working group" was tasked with reviewing and reporting "fraud,  
11 significant credit risks, significant servicing risks, EPD issues, non-owner occupied issues, [and]  
12 fair lending issues." Despite the inception of this new "working group," however, no self-  
13 reporting occurred.

14 118. Rather, in August 2004, the "working group" agreed not to follow the HUD  
15 reporting requirements and not to report loans to HUD that it internally identified as containing  
16 material violations of HUD requirements. In an August 13, 2004 memorandum bearing the  
17 subject line "Reporting Process to HUD," the author recounts issues discussed in the recent  
18 working group call, stating that "[Wells Fargo Home Mortgage] is required to report violations  
19 and deficiencies that are identified. Fraud or other serious deficiencies must be reported to  
20 Director of HUD ... within 60 days of initial discovery. It was agreed that loans reviewed and  
21 rated material through the Quality Assurance process would not necessarily meet that definition."

22 119. Later, the Quality Control working group further unilaterally narrowed the  
23 Company's reporting obligations. In response to an April 2005 e-mail from Wells Fargo's FRM  
24 Director which laid out numerous HUD reporting requirements and requested specific guidance  
25 on reporting broker fraud, the VP of Quality Control stated that he and two others had reviewed  
26 the reporting requirements and had "determined 'serious deficiencies' did not include material  
27 findings and unallowable fees, but that systemic fraud issues need to be reported to HUD ... One-  
28 off borrower fraud generally would not be reported, but [loan officer], broker, appraiser, realtor

1 fraud would be." Yet, the Company did not even comply with its own unilaterally narrowed  
2 formulation of Wells Fargo's reporting obligation, and continued not to self-report any loans.

3 120. In an inter-office memorandum to "Senior Management" on August 4, 2005,  
4 before the Company had begun self-reporting to HUD, the Wells Fargo "HUD Deficiency  
5 Reporting Cross Functional Team" listed the following two concerns about starting to self-  
6 report: First, the team highlighted that "[b]y self-reporting all significant audit results and  
7 suspected fraud to HUD on FHA originations, [Wells Fargo Home Mortgage] has potentially  
8 given HUD a list of loans which could result in indemnification from HUD." In other words, the  
9 Company's bottom line would be hurt by complete self-reporting. Second, the team underscored  
10 that "[Wells Fargo Home Mortgage] will be reporting audit findings for wholesale brokers. This  
11 could cause client issues or concerns, depending upon direction other lenders take." Again, the  
12 Individual Defendants' overriding concern rested with losing some wholesale FHA business,  
13 thereby affecting the Company's profits.

14 121. Then in 2006, in response to questioning by HUD, the Company issued improper  
15 statements regarding its purported compliance with its self-reporting obligations. In a January  
16 18, 2006 letter responding to HUD's concerns, the Division Presidents of Wells Fargo Home  
17 Mortgage acknowledged that "HUD requires that 'serious deficiencies, patterns of non-  
18 compliance, or fraud uncovered by mortgagees must be report[ed] in writing,'" and then falsely  
19 represented that "[p]rocedures are, and have been, in place to report appropriate items to the  
20 HUD Homeownership Centers." The Division Presidents then described these procedures,  
21 which supposedly included "obtaining input from various groups including Quality Assurance,  
22 Fraud Risk management, Legal Servicing, etc.," and assured HUD that "[r]egular meetings are  
23 held to discuss what files should be reported." They explained the Company's prior self-  
24 reporting policy as follows: "[h]istorically Wells Fargo interpreted HUD's [self-reporting]  
25 requirement ... to mean that reporting was required on incidents that involve several files or  
26 patterns of fraud or non-compliance...." Based on this interpretation, the Division Presidents  
27 continued, "Wells Fargo did not report *every* incident of fraud or non-compliance that involved a  
28 single instance or file, but rather focused on reporting larger global fraud issues which involved

1 numerous parties and files." They assured HUD, however, that the Company had now  
2 "broadened its reporting requirements to meet the guidance provided" in HUD's May 27, 2005  
3 Mortgagee Letter. Wells Fargo's abject failure to report a single loan prior to October 2005,  
4 however, renders those representations inaccurate.

5 122. Following HUD's inquiry, Wells Fargo began to self-report loans, but even then  
6 the Individual Defendants failed to adhere to the Company's own self-reporting policy and, more  
7 importantly, knowingly or recklessly failed to comply with HUD's self-reporting regulations.  
8 Indeed, through December 2010, the Company's self-reporting was cursory at best. During a  
9 five-year period, Wells Fargo, the largest originator and sponsor of FHA home mortgages for  
10 much, if not all, of this period, self-reported fewer than 250 loans.

11 123. It was not until June 2011, shortly after the United States Attorney's Office for the  
12 Southern District of New York served Wells Fargo with a subpoena, that Wells Fargo began self-  
13 reporting a more significant quantity of loans, and, on information and belief, retroactively  
14 reported loans back to the beginning of 2011.

15 124. Wells Fargo's complete failure to self-report bad loans prior to October 2005, and  
16 woefully inadequate reporting thereafter, stands in stark contrast to the findings of Wells Fargo's  
17 QA reviews. From January 2002 through December 2010, Wells Fargo reported 238 loans to  
18 HUD. In contrast, during that same time, Wells Fargo QA identified 6,558 loans as having a  
19 material violation. Of those, 2,628 were identified through randomly sampled QA reviews,  
20 3,142 from mandated EPD reviews, and an additional 788 through targeted reviews. Wells  
21 Fargo failed to report 6,320 of these "material" risk loans to HUD. Those loans alone resulted in  
22 FHA's payment of nearly \$190 million in FHA benefits on defaulted mortgage loans.

23 125. Moreover, on information and belief, the 6,558 "material" risk-rated loans that  
24 QA identified do not constitute the universe of bad loans that Wells Fargo was aware of and  
25 failed to self-report. For example, the 6,558 loans do not include any loans that FRM determined  
26 during this period were affected by fraud or other serious violations. Accordingly, there are  
27 additional loans containing material violations that Wells Fargo should have self-reported to  
28 HUD and that almost certainly resulted in insurance claims that FHA was required to satisfy.

1           126. Further, Wells Fargo QA failed to review all EPDs as required under the HUD  
2 Handbook. That is because, according to QA, the loan file often "was not available for review."  
3 On average, approximately 20% of the FHA EPDs were not reviewed each month by QA. For  
4 example, in its July 2002 report, QA reported that there were thirty-six FHA EPDs, but QA  
5 reviewed only twenty-four. The next month there were twenty-nine FHA EPDs, but QA  
6 reviewed only twenty. The following month there were forty-one EPDs, but QA reviewed only  
7 thirty.

8           127. This failure is particularly problematic because a loan that is sixty days in default  
9 within the first six months after origination has an increased likelihood of fraud or other serious  
10 violations. As a result of QA's failure to review all EPDs, Wells Fargo never identified  
11 additional loans that contained unacceptable risk and never self-reported these loans to HUD. As  
12 a consequence, HUD never had the opportunity to investigate these loans or request  
13 reimbursement or indemnification, and FHA was required to pay insurance claims on these loans  
14 when they defaulted.

15           128. Accordingly, Wells Fargo's failure to self-report over 6,000 FHA loans that did  
16 not meet HUD requirements and review all EPDs caused the FHA to pay hundreds of millions of  
17 dollars in insurance claims for loans that were not eligible for insurance. The United States  
18 Attorney's Office for the Southern District of New York filed suit on October 9, 2012, seeking to  
19 recover these damages in connection with Wells Fargo's residential mortgage lending business.

#### 20                                   **DAMAGES TO WELLS FARGO**

21           129. As a result of the Individual Defendants' improprieties, Wells Fargo engaged in  
22 illicit business practices which include knowingly or recklessly underwriting bad loans and  
23 fraudulently inducing the FHA to insure any losses as a result thereof.

24           130. As a direct and proximate result of Individual Defendants' actions, Wells Fargo  
25 has expended and will continue to expend significant sums of money. Such expenditures  
26 include, but are not limited to:

27  
28



1 (a) costs incurred in defending against, and the potential settlement of, legal  
2 proceedings brought against the Company including the action brought by the United States  
3 Attorney for the Southern District of New York;

4 (b) any potential fines, sanctions, and disciplinary actions taken against the  
5 Company as a result of the illegal activities engaged in by the Individual Defendants; and

6 (c) costs incurred from compensation and benefits paid to the defendants who  
7 have breached their duties to Wells Fargo.

8 131. Moreover, these actions have irreparably damaged Wells Fargo's business,  
9 corporate image, and goodwill. The Individual Defendants' involvement in the detrimental  
10 subprime mortgage-lending business has caused the Company to incur public scorn and has  
11 impaired Wells Fargo's credibility with HUD. In addition, for at least the foreseeable future,  
12 Wells Fargo will suffer from what is known as the "liar's discount," a term applied to the stocks  
13 of companies who have been implicated in illegal behavior and have perpetrated a fraud, such  
14 that Wells Fargo's ability to raise equity capital or debt on favorable terms in the future is now  
15 impaired.

#### 16 DERIVATIVE AND DEMAND FUTILITY ALLEGATIONS

17 132. Plaintiff brings this action derivatively in the right and for the benefit of Wells  
18 Fargo to redress injuries suffered, and to be suffered, by Wells Fargo as a direct result of  
19 breaches of fiduciary duty, waste of corporate assets, and unjust enrichment, as well as the aiding  
20 and abetting thereof, by the Individual Defendants. Wells Fargo is named as a nominal  
21 defendant solely in a derivative capacity. This is not a collusive action to confer jurisdiction on  
22 this Court that it would not otherwise have.

23 133. Plaintiff will adequately and fairly represent the interests of Wells Fargo in  
24 enforcing and prosecuting its rights.

25 134. Plaintiff is a Wells Fargo shareholder, was a shareholder of Wells Fargo at the  
26 time of the wrongdoing complained, and has continuously been a shareholder of Wells Fargo.

27 135. The current Board of Wells Fargo consists of the following fifteen individuals:  
28 defendants Stumpf, Baker, Quigley, Milligan, Swenson, Engel, Runstad, Hernandez, Sanger,

1 Dean, Chen, Moore, and James, and non-defendants Elaine L. Chao and Federico F. Peña.  
 2 Plaintiff has not made any demand on the Board because such a demand would be a futile and  
 3 useless act, particularly for the reasons stated below.

4 **Demand Is Excused as to Defendants Stumpf, Baker, Quigley, Milligan, Swenson, Engel,**  
 5 **Runstad, Hernandez, Sanger, Dean, Chen, Moore, and James Because Allowing the**  
 6 **Company to Engage in Illegal and Improper Business Practices Was Not a Valid Exercise**  
 7 **of Business Judgment**

8 136. Defendants Stumpf, Baker, Quigley, Milligan, Swenson, Engel, Runstad,  
 9 Hernandez, Sanger, Dean, Chen, Moore, and James breached their duty of care by causing or  
 10 allowing the Company to engage in fraudulent and deceptive underwriting practices to issue  
 11 mortgages and then make false certifications about their condition to the FHA. The problematic  
 12 loans were not eligible for the government insurance, and when they soured, the FHA was  
 13 obligated to cover the losses. Accordingly, Wells Fargo's failure to self-report over 6,000 FHA  
 14 loans that did not meet HUD requirements, and failure to review all EPDs, caused FHA to pay  
 15 hundreds of millions of dollars in insurance claims for loans that were not eligible for insurance.  
 16 These defendants' decision to permit such widespread illegal conduct by the Company have  
 17 exposed Wells Fargo to legal liability, civil sanctions, fines, and other penalties. Causing the  
 18 Company to engage in improper and illegal acts that render it vulnerable to hundreds of millions  
 19 of dollars in legal liability is not a protected business decision and such conduct can in no way be  
 20 considered a valid exercise of business judgment. Accordingly, demand upon defendants  
 21 Stumpf, Baker, Quigley, Milligan, Swenson, Engel, Runstad, Hernandez, Sanger, Dean, Chen,  
 22 Moore, and James is excused.

23 **Demand Is Excused Because Defendants Stumpf, Baker, Quigley, Milligan, Swenson,**  
 24 **Engel, Runstad, Hernandez, Sanger, Dean, Chen, Moore, and James Face a Substantial**  
 25 **Likelihood of Liability for Their Misconduct**

26 137. Defendant Stumpf, as Chairman, CEO, and President was responsible for the  
 27 Company's operations and public disclosures. Defendant Stumpf was responsible for preserving  
 28 the Company's reputation by following applicable laws, rules, and regulations. However, in  
 complete abdication of his fiduciary duties, defendant Stumpf knowingly, recklessly, or with  
 gross negligence caused the Company to implement and maintain illicit underwriting and self-

1 reporting practices that have caused the Company to incur significant legal liability, and  
2 jeopardize the Company's most prized asset, its reputation. In further breach of his fiduciary  
3 duties, defendant Stumpf continued to maintain that the Company's mortgage loans were of high  
4 quality, and its underwriting was sound, despite facing numerous red flags alerting him to the  
5 contrary. Because defendant Stumpf breached his fiduciary duties, he faces a substantial  
6 likelihood of liability, and demand upon him is futile.

7 138. Defendants Baker, Quigley, Milligan, Swenson, Engel, Runstad, Hernandez,  
8 Sanger, Dean, Chen, Moore, and James face a substantial likelihood of liability due to their  
9 breaches of their duties of loyalty. These defendants consciously allowed the Company to  
10 engage in a continuous and pervasive scheme spanning almost a decade to underwrite as many  
11 mortgages as possible, without considering the consequences because they knew the FHA would  
12 step in and insure any losses. Given the extensive nature of fraud, these defendants knew or  
13 were reckless in not knowing of the illicit underwriting and reporting practices employed by the  
14 Company. Moreover, defendants Baker, Quigley, Milligan, Swenson, Engel, Runstad,  
15 Hernandez, Sanger, Dean, Chen, Moore, and James further exacerbated their misconduct by  
16 allowing the Company to issue a series of improper statements to HUD regarding the quality of  
17 the Company's residential mortgage loans in order to avoid any indemnification claims from the  
18 FHA. As detailed herein, defendants Baker, Quigley, Milligan, Swenson, Engel, Runstad,  
19 Hernandez, Sanger, Dean, Chen, Moore, and James's misconduct has devastated the Company's  
20 reputation and caused it to incur enormous costs arising from the pending government litigation.  
21 Accordingly, defendants Baker, Quigley, Milligan, Swenson, Engel, Runstad, Hernandez,  
22 Sanger, Dean, Chen, Moore, and James face a substantial likelihood of liability for breaching  
23 their duty of loyalty and wasting corporate assets, and demand upon them is futile.

24 139. Defendants Baker, Quigley, Milligan, Swenson, Runstad, Hernandez, Dean, and  
25 Moore were members of the Audit and Examination Committee during the time of the  
26 wrongdoing. These defendants had additional and heightened responsibility to monitor the  
27 "Company policies and management activities related to ... operational risk and legal and  
28 regulatory compliance...." This they did not do. The Audit and Examination Committee was

1 active during the time of the wrongdoing, meeting a total of ninety-two times between 2002 and  
2 2011. During at least some of these meetings, the Audit and Examination Committee had access  
3 to numerous internal monthly reports from the QA and FRM departments summarizing their  
4 findings on bad loans containing "Material" risk ratings in violation of HUD's requirements.  
5 Similarly, defendants Baker, Quigley, Milligan, Swenson, Runstad, Hernandez, Dean, and  
6 Moore had access to the high material violation rates for FHA loans that went into EPD. Despite  
7 facing these blatant red flags during their time on the Audit and Examination Committee,  
8 however, these defendants consciously allowed the Company's deceptive and fraudulent  
9 practices, and inadequate reporting to HUD to continue. Additionally, defendants Baker,  
10 Quigley, Milligan, Swenson, Runstad, Hernandez, Dean, and Moore reviewed and approved a  
11 series of improper statements regarding the purported quality of the Company's residential  
12 mortgage loans and also the Company's compliance with applicable HUD rules and regulations.  
13 Accordingly, the Audit and Examination Committee Defendants breached their fiduciary duty of  
14 loyalty and good faith because they participated in the wrongdoing described herein. Thus, the  
15 Audit and Examination Committee Defendants face a substantial likelihood of liability for their  
16 breach of fiduciary duties so any demand upon them is futile.

17 140. The acts complained of constitute violations of the fiduciary duties owed by Wells  
18 Fargo's officers and directors and are incapable of ratification.

19 141. Wells Fargo has been and will continue to be exposed to significant losses due to  
20 the wrongdoing complained of herein. Despite the Individual Defendants having knowledge of  
21 the claims and causes of action raised by plaintiff, the Individual Defendants and the current  
22 Board have not filed any lawsuits against themselves or others who were responsible for the  
23 wrongful conduct to attempt to recover for Wells Fargo any part of the damages Wells Fargo  
24 suffered and will suffer thereby. The Board's stubborn failure to investigate, correct, and  
25 commence legal action against those responsible for the misconduct alleged herein in the face of  
26 heavy media and investor scrutiny on the matter, demonstrates that the Board is hopelessly  
27 incapable of independently addressing any legitimate demand.  
28



**COUNT I**

### For Breach of Fiduciary Duties Against the Individual Defendants

143. Plaintiff incorporates by reference and realleges each and every allegation contained above, as though fully set forth herein.

144. As alleged in detail herein, Individual Defendants by reason of their positions as officers and directors of Wells Fargo and because of their ability to control the business and corporate affairs of Wells Fargo, owed the Company fiduciary obligations of due care and loyalty, and were and are required to use their utmost ability to control and manage Wells Fargo in a fair, just, honest, and equitable manner.

145. The Officer Defendants owed Wells Fargo the highest duty of loyalty and care. These defendants breached their duty of loyalty and care by knowingly, recklessly, or with gross negligence causing the Company to engage in improper underwriting and reporting practices. As demonstrated by the Company's internal documents and e-mails, management knew or recklessly disregarded that these illicit practices were being implemented. Accordingly, the Officer Defendants breached their duty of care, good faith, and loyalty.

146. The Director Defendants of the Company owed Wells Fargo the highest duty of loyalty. These defendants breached their duty of loyalty by knowingly or recklessly causing the Company to underwrite bad loans and inducing the Government to insure these loans when they

1 defaulted. The Director Defendants also knowingly or recklessly reviewed and approved  
2 improper statements concerning the quality of the Company's loans and its compliance with  
3 applicable rules and regulations to HUD. Accordingly, the Director Defendants breached their  
4 duty good faith and loyalty.

5 147. The Audit and Examination Committee Defendants breached their fiduciary duty  
6 of loyalty by knowingly or recklessly allowing the Company's core mortgage-lending business to  
7 defraud the Government. Moreover, the Audit and Examination Committee Defendants  
8 reviewed and approved a series of improper statements regarding the purported quality of the  
9 Company's residential mortgage loans and also the Company's purported compliance with HUD  
10 rules and regulations.

11 148. As a direct and proximate result of Individual Defendants' foregoing breaches of  
12 fiduciary duties, the Company has suffered significant damages, as alleged herein.

13 149. Plaintiff, on behalf of Wells Fargo, has no adequate remedy at law.

## 14 **COUNT II**

### 15 **Against the Individual Defendants for Waste of Corporate Assets**

16 150. Plaintiff incorporates by reference and realleges each and every allegation  
17 contained above, as though fully set forth herein.

18 151. As a result of the illegal business practices detailed herein, the Individual  
19 Defendants have caused Wells Fargo to incur substantial costs. In fact, the Company is incurring  
20 additional costs from the pending lawsuit brought by the United States Attorney's Office for the  
21 Southern District of New York. The Government is seeking hundreds of millions of dollars in  
22 damages.

23 152. Individual Defendants also wasted corporate assets by paying improper  
24 compensation and bonuses to certain of its executive officers and directors that breached their  
25 fiduciary duty.

26 153. As a result of the waste of corporate assets, Individual Defendants are liable to the  
27 Company.

28 154. Plaintiff, on behalf of Wells Fargo, has no adequate remedy at law.

**COUNT III**

**Against All Individual Defendants for Unjust Enrichment**

155. Plaintiff incorporates by reference and realleges each and every allegation set forth above, as though fully set forth herein.

156. By their wrongful acts and omissions, Individual Defendants were unjustly enriched at the expense of and to the detriment of Wells Fargo. Individual Defendants were unjustly enriched as a result of the compensation and director remuneration they received while breaching fiduciary duties owed to Wells Fargo.

157. Plaintiff, as a shareholder and representative of Wells Fargo, seeks restitution from these defendants, and each of them, and seeks an order of this Court disgorging all profits, benefits, and other compensation obtained by these defendants, and each of them, from their wrongful conduct and fiduciary breaches.

158. Plaintiff, on behalf of Wells Fargo, has no adequate remedy at law.

**PRAYER FOR RELIEF**

WHEREFORE, plaintiff demands for a judgment as follows:

A. Against all the Individual Defendants and in favor of the Company for the amount of damages sustained by the Company as a result of Individual Defendants' breaches of fiduciary duties, waste of corporate assets, and unjust enrichment;

B. Directing Wells Fargo to take all necessary actions to reform and improve its corporate governance and internal procedures to comply with applicable laws and to protect Wells Fargo and its shareholders from a repeat of the damaging events described herein, including, but not limited to, putting forward for shareholder vote, resolutions for amendments to the Company's By-Laws or Articles of Incorporation and taking such other action as may be necessary to place before shareholders for a vote the following Corporate Governance Policies:

1. a proposal to strengthen Board oversight of Wells Fargo's underwriting and reporting policies and procedures, including fair disclosure to the Government of such policies and procedures;

2. a proposal to strengthen the Company's disclosure controls over the quality of its residential mortgage loans;

3. a proposal to strengthen the Board's supervision of operations and develop and implement procedures for greater shareholder input into the policies and guidelines of the Board; and

4. a provision to permit the shareholders of Wells Fargo to nominate at least three candidates for election to the Board;

C. Extraordinary equitable and/or injunctive relief as permitted by law, equity, and state statutory provisions sued hereunder, including attaching, impounding, imposing a constructive trust on or otherwise restricting defendants' assets so as to assure that plaintiff on behalf of Wells Fargo has an effective remedy;

D. Awarding to Wells Fargo restitution from the defendants, and each of them, and ordering disgorgement of all profits, benefits, and other compensation obtained by the defendants;

E. Awarding to plaintiff reasonable attorneys' fees, consultant and expert fees, costs, and expenses; and

F. Granting such other and further relief as the Court deems just and proper.

## JURY DEMAND

**Plaintiff demands a trial by jury.**

Dated: November 21, 2012

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VERIFICATION

I, Richard Gulbrandsen, hereby declare as follows:

I am the plaintiff in the within entitled action. I have read the Verified Shareholder Derivative Complaint for Breach of Fiduciary Duty, Waste of Corporate Assets, and Unjust Enrichment. Based upon discussions with and reliance upon my counsel, and as to those facts of which I have personal knowledge, the Complaint is true and correct to the best of my knowledge, information, and belief.

I declare under penalty of perjury that the foregoing is true and correct.

Signed and Accepted:

Dated: 11/20/2012

Richard M. Gulbrandsen  
RICHARD GULBRANDSEN